PHILIP MORRIS MANAGEMENT CORP.
CORPORATE AUDIT DEPARTMENT
RICHMOND OFFICE

PHILIP MORRIS USA
New York, New York

Review of Magazine & Newspaper Procurement at Backer Spielvogel Bates, Inc.

Period Reviewed: January, 1990 - June, 1991

Audit Report PM USA DRAFT

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Auditors:

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I. BACKGROUND

Backer Spielvogel Bates, Inc. (Backer) is PM USA's agency of record responsible for procuring all magazine and newspaper placements for its Parliament, Cartier and Bristol brands. The total of these advertising expenditures for 1990 and 1991 are summarized as follows (in thousands):

1990	Parliament	Cartier	Bristol	Total
Magazines	$6,686	$1,208	$ -	$7,894
Newspapers	404	-	312	716
	$7,090	$1,208	$ 312	$8,610
1991				
Magazines	$4,312	$ 107	$ -	$4,419
Newspapers	219	580	643	1,442
	$4,531	$ 687	$ 643	$5,861

The decreased spending for Parliament and Cartier reflect more focused marketing for these brands to the Northeast and West Coast regions, respectively. The increase for Bristol is due to higher spending for price value brands.

II. SCOPE

The Philip Morris Corporate Audit Department has completed a review of the internal controls at Backer Spielvogel Bates, Inc. for media placement expenditures for the period January, 1990 through June, 1991.

Specifically, our review included media procurement procedures, media performance monitoring and reporting, and disbursement and billing controls for magazines and newspapers.

III. REPORT REVIEW

The results of our audit were discussed at an exit conference on January 16, 1992 with S. R. Lizza, Assistant Controller, New York Headquarters; M. G. Saine, Manager, Accounting and R. L. Stirlen, Director Media.

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The draft audit report was issued to E. Merlo, V. P. Marketing Services on February 19, 1992 requesting Management Action Plans for the findings reported. The Management Action Plans included in this report were received on _____, 1992.

IV. AUDIT FINDINGS, RECOMMENDATIONS AND MANAGEMENT ACTION PLANS

1. PM USA could achieve savings of approximately $100,000 for 18 months if forecasted insertion levels were used to negotiate all magazine discount rates.

Discount rates with several magazines are initially contracted using less than forecasted insertion levels in order to avoid shortrate payments to publishers. As such, higher rates are initially paid since publisher's rates decrease as the level of insertions increase. The publisher subsequently issues credits for all prior purchases for the year based upon the difference between the contracted and actual insertion levels. However, PM USA loses the investment earnings from these credits.

Our testing indicated that discount rates for approximately 20% of all magazines used by PM USA were negotiated using less than forecasted insertion levels, resulting in higher rates. We estimate that if forecasted insertion levels had been used to negotiate rates, PM USA could have reduced the amount of subsequent credits and saved approximately $100,000 in lost earnings for 18 months.

The discount rates are negotiated based upon the combined insertion levels of all PM operating companies. The rates and levels are reviewed and revised quarterly by management. PM USA's payments to magazine publishers for January, 1990 to June, 1991 totalled approximately $135 million.

Recommendation

PM USA's annual forecasted insertion levels for magazines should be used for negotiating discount rates with publishers to take immediate advantage of lower rates.

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2. **PM USA does not have a written contract with Backer to govern their agency relationship.**

No written contract exists to govern PM USA's purchase of advertising services from Backer. Thus critical terms such as services to be performed, agency fee basis, billing terms, and exclusivity and indemnification rights are not documented. As such, the duties and responsibilities of the parties could be misinterpreted.

Recommendation

PM USA should establish a written contract with Backer that should include, at a minimum, the following:

- o Services to be performed
- o Agency fee basis
- o Billing terms
- o Audit clause & records retention
- o Term of the contract
- o Exclusivity clause
- o Indemnification clause
- o Reasons for termination
- o Ownership of materials
- o Insurance coverage
- o Confidentiality

Management Action Plan

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